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DEPARTMENT FOR SCA/INS
MCC FOR D NASSIRY AND E BURKE

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SUBJECT: SRI LANKA: DEPUTY USTR URGES PRESIDENT TO IMPROVE
INVESTMENT CLIMATE

Classified By: Ambassador Robert O. Blake, Jr., for reasons 1.4(b,d).

11. (C) SUMMARY: Sri Lankan President Mahinda Rajapaksa, in a meeting on November 30, asked Deputy U.S. Trade Representative Karan Bhatia to help facilitate completion of a Millennium Challenge Compact for his country. Rajapaksa made it clear that Sri Lanka was prepared to drop controversial irrigation projects in favor of alternative infrastructure projects such as roads. Bhatia urged Rajapaksa to take measures to improve Sri Lanka's investment climate, including legal protections for investors. The single greatest deterrent to U.S. investment in the country was the sense of instability stemming from the continued ethnic conflict, he noted. Ambassador Blake reiterated the need for military restraint and improvement in the government's human rights record, absent which the U.S. could be obliged to withhold military assistance. Bhatia thanked Sri Lanka for its efforts in the Doha round to date, commenting that the U.S. hoped that progress on agriculture would lead to overall success in the WTO negotiations. End summary.

NEED FOR MILITARY RESTRAINT, IMPROVEMENT IN HUMAN RIGHTS

12. (C) Ambassador Blake began the discussion with a brief readout of the Washington Co-Chairs meeting on November 20-21. He told President Rajapaksa that the Co-Chairs were concerned about the downward spiral of violence in Sri Lanka. However, the Co-Chairs placed great hope in the agreement between the two major Sinhalese parties to cooperate on developing a viable peace proposal that could form the basis for peace talks with the LTTE.

13. (C) Ambassador also mentioned the strong statement of support for Sri Lanka given by U/S Burns at the conclusion of the Co-Chairs meeting. Rajapaksa nodded vigorous agreement and expressed appreciation for the support. He thanked the Ambassador for his widely publicized rebuttal of LTTE chief Prabhakaran's November 27 speech, in which Ambassador had clearly rejected both the objective of Tamil secession and

the use of violence to achieve it.

¶4. (C) Ambassador also brought up the current visit of Army Commander Sarath Fonseka to Washington. While Fonseka's U.S. interlocutors had reiterated U.S. support for Sri Lanka's right to defend itself, Ambassador cautioned that this support could not be unconditional. The U.S. urged the Sri Lankan government to put an end to human rights violations by the security forces and other groups. Ambassador also noted the need for military restraint and requested that Sri Lanka refrain from offensive military actions. Otherwise, U.S. ability to support the GSL with military assistance would be jeopardized.

U.S SEEKS MORE DYNAMIC GROWTH IN TRADE

¶5. (SBU) Ambassador Bhatia reviewed the role of the U.S. Trade Representative in international trade policy. He noted the increasing importance of U.S. economic ties to South Asia as measured by rapidly expanding trade volumes with many key partners, including India. The U.S. had a good economic relationship with Sri Lanka, he said, but would like to see more dynamic growth of trade, "well into the double digits," above the modest 3-4% in recent years. This, he suggested, stemmed for a comparatively less attractive trade regime of higher tariffs and non-tariff barriers, a possible need for renewed economic reform, and failure to take better advantage of U.S. GSP programs to promote trade with developing countries.

¶6. (SBU) While the U.S. trade deficit with Sri Lanka was not large in absolute terms, Bhatia said, there was still a

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strong imbalance, as Sri Lankan exports were roughly ten times its imports from the U.S. The U.S. clearly would like to see this change over time. Bhatia emphasized the critical role that appropriate macroeconomic policies, effective IPR protection, and trade-capacity building measures had to play in growing Sri Lanka's economy.

MILLENNIUM CHALLENGE COMPACT

¶7. (SBU) President Rajapaksa asked how it would be possible to expedite the conclusion of a Millennium Challenge Compact. The process has taken over two years, he noted, and Sri Lanka was anxious to proceed. Bhatia conceded that the process was taking longer than anticipated. The large number of irrigation projects had held up consideration of the whole package because of environmental and other concerns.

¶8. (SBU) Rajapaksa indicated that his government was prepared to drop the irrigation measures in favor of other less complicated infrastructure projects, such as roads. Bhatia concurred that this was a good idea, pointing out that getting goods to market on time was a critical element in any value chain. Ambassador Blake suggested developing other projects to replace the controversial irrigation proposals. Rajapaksa's chief of staff Lalith Weeratunga mentioned the second international airport for Sri Lanka as a key infrastructure project for developing the "hinterlands," so that previously marginal areas could contribute to GDP growth. This should be made attractive to international investors. (Post does not believe, however, that the GSL is looking to finance the new airport through MCC.)

SECURITY AND INVESTMENT CLIMATE CONCERNS

¶9. (C) Bhatia told President Rajapaksa of two major concerns for Sri Lanka's growth prospects. First, many investors had been scared away by the deteriorating security situation in the country. Of 180 American companies that planned to accompany Commerce U/S Frank Lavin to India, only three had

chosen to join a similar event for Sri Lanka despite personal letters to all the businesses from Ambassador Blake. Bhatia said the daily headlines of increasing violence were a factor in discouraging travel by these companies. Second, there were still concerns about the sanctity of contracts in Sri Lanka.

¶10. (C) On the security situation, Rajapaksa showed irritation, commenting that the conflict was not a problem for the economy in the Colombo area, but that the Colombo dateline on reports of violence in Sri Lanka made it appear so. This, he inferred, exaggerated the security situation, which was unhelpful.

¶11. (SBU) On the contract sanctity issue, Bhatia noted strong complaints from a Swedish/American carbon blade company, Jacobi Carbons, regarding after-the-fact imposition of purchasing restrictions. This damaged Sri Lanka's reputation among foreign investors. Rajapaksa agreed, noting that some recent Sri Lanka Supreme Court decisions in that case had not been helpful. The government would seek to correct these through legislation. He had also spoken to his economic ministers about this, he said. "The question is, who is running the country? We, or the Supreme Court?" Rajapaksa said that he hoped the Trade and Investment Framework Agreement discussions would provide the right forum to discuss these issues thoroughly.

COOPERATION ON DOHA AGENDA

¶12. (SBU) Bhatia closed by thanking the President for his country's strong support for the Doha agenda and asked for

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continued cooperation, particularly in the area of agriculture. Bhatia urged that Sri Lanka play a constructive role in the G-33 group of countries. The Sri Lanka delegation to the WTO worked closely with its U.S. counterparts on non-agricultural market access and services, he noted.

The USTR delegation cleared this message.
BLAKE